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PP RUEHAG RUEHDBU
DE RUEHKB #0540/01 0971155
ZNY CCCCC ZZH
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FM AMEMBASSY BAKU
TO RUEHC/SECSTATE WASHDC PRIORITY 0094
INFO RUCNCIS/CIS COLLECTIVE
RUCNMEM/EU MEMBER STATES COLLECTIVE
RUEKJCS/SECDEF WASHDC
RHEHNSC/NSC WASHDC
RHMFISS/CDR USEUCOM VAIHINGEN GE
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RHEBAAA/DEPT OF ENERGY WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000540

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E.O. 12958: DECL: 04/07/2016

TAGS: [ECON](#) [EPET](#) [ENRG](#) [PREL](#) [PGOV](#) [KDEM](#) [AJ](#)

SUBJECT: PRESIDENT ALIYEV N ENERGY SECURITY, TRANSCASPIAN
PIPELINE

Classified By: Ambassador Reno L. Harnish III per 1.4 (b,d).

11. (C) Summary: In an April 3 meeting with S/P Director Krasner and EUR DAS Bryza, President Aliyev said he looked forward to further development of Azerbaijan's gas reserves and creation of a new TransCaspian pipeline to export Central Asian gas to European markets as an important "second stage" in Azerbaijan's development. In order for Azerbaijani and Central Asian gas to reach European markets, however, Aliyev said that he needs strong political support from the USG. He also welcomed USG help in resolving Caspian demarcation issues. Krasner and Bryza urged Aliyev to ensure that the May 13 parliamentary rerun elections are conducted in a free and transparent manner. Aliyev agreed that further democratic reform was needed but cautioned that democratic development must be viewed in a broad regional context. End summary.

12. (SBU) S/P Director Stephen Krasner and EUR DAS Matt Bryza paid a call on Azerbaijani President Ilham Aliyev on April 3. Aliyev, in his usual fashion, was accompanied only by Foreign Policy Advisor Novruz Mammadov. Ambassador Harnish and Pol/Econ chief (notetaker) also attended the meeting.

ENERGY SECURITY: TRANSCASPIAN PIPELINE

13. (C) Noting that Azerbaijan had been a pioneer in Caspian energy development, Aliyev said that construction of the BTC and SCP pipelines did not indicate that Azerbaijan's energy mission had been accomplished. On the contrary, because recent events demonstrated that energy has become "a tool in other countries' hands," Azerbaijan now had an opportunity to counter Russia's monopoly and explore new European markets. In order to do so, however, Azerbaijan needs the support of the United States. "This will not work without a coordinating role played by the United States," Aliyev said.

14. (C) Bryza cautioned that Italy and Greece -- potential new energy markets for Azerbaijan -- were being told by Gazprom that Azerbaijan had no surplus gas to supply to Europe. Bryza urged Aliyev to act quickly or risk losing this new market. The GOAJ should accelerate investments and explain to the Europeans the production expected from Shah Deniz development, 8-10 bcm expected by 2012 from phase 2 alone.

15. (C) Aliyev responded that this was a new phase for Azerbaijan. When the GOAJ first developed plans to exploit the Shah Deniz gas field, production was expected only to cover the needs of Azerbaijan and Georgia, with an additional

2-3 bcm to export to Turkey. With an estimated 1 trillion bcm in new untapped gas reserves (expected to be proven soon by geologists, according to Aliyev) as well as large volumes of condensates and non-associated gas from the ACG field, Azerbaijan needs to change its thinking and consider exports.

Azerbaijan could not decide this on its own, Aliyev said. Azerbaijan must take steps and the Europeans must provide market guarantees. Then, he continued, Azerbaijan can think about bringing Kazakh and Turkmen gas into the network. As part of this equation, however, Azerbaijan must end its own dependence on Russian gas. He worried that Russia might raise prices for gas shipped to Azerbaijan to apply political and commercial pressure on Baku.

16. (C) Aliyev urged the United States to play a role in helping Azerbaijan secure new gas markets in Europe. Aliyev had meetings on this issue in Brussels two years ago, he said, but the discussions never moved beyond the theoretical.

Azerbaijan needs USG help to move beyond theoretical discussion to practical measures to diversify Europe's energy supplies. A U.S. role also would help Kazakhstan, Aliyev continued, as it has 100 bcm in gas reserves but no way to export to Europe without transiting Russia. Aliyev said that he had spoken to Kazakh President Nazarbayev recently, and Nazarbayev agreed that a new TransCaspian pipeline to bring Central Asian gas into Azerbaijani pipelines was a real possibility. Aliyev estimated the export capacity of this new pipeline at 90 bcm, as Azerbaijan would be able to feed 25-30 bcm into the system, while Kazakhstan could deliver 50-60 bcm. Aliyev noted that the TransCaspian pipeline could then cross the Black Sea through a "new Blue Stream" pipeline, transiting into Ukraine and Poland.

17. (C) Aliyev said he would appreciate the USG's help in

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resolving Caspian demarcation issues. Aliyev welcomed Bryza's news that Turkmen President Niyazov had asked for USG help in this issue, noting that Azerbaijan had very little contact with Turkmenistan and found Niyazov's behavior difficult to predict. His own recent contact with the Government of Turkmenistan, Aliyev wryly noted, had come through two letters of complaint written by Deputy Ministers.

Cooperation with Turkmenistan and agreement on Caspian demarcation is key to moving forward on regional energy issues. For example, Aliyev said, if Turkmenistan would agree on joint ownership and development of the Kapaz field, Azerbaijan would be ready to move forward on production, giving Turkmenistan a majority share. If the Turkmen want U.S. involvement, Aliyev concluded, "we'll support that." Bryza replied that Niyazov still wanted all of Kapaz and joint exploration of the ACG fields under production by Azerbaijan and its international partners.

18. (C) Ambassador Harnish reminded Aliyev that further exploitation of Caspian energy resources also could lead to the development of Azerbaijan's construction and shipping industries. U.S. firm McDermott already was well-positioned to provide construction services throughout the Caspian; all that it needs is a duty-free zone in Azerbaijan. Aliyev agreed that promotion of a construction export business was in Azerbaijan's interest and said he already had instructed SOCAR and the Ministry of Economic Development to begin work on a "special tax situation." Aliyev added that he is considering the creation of a general tax-free zone in Azerbaijan. In general, Aliyev said, Azerbaijan must forget that it has oil and think about it what it must do to develop its non-energy sectors.

DEMOCRACY AND TRANSPARENCY

19. (C) Krasner cautioned Aliyev to guard against the dangers of energy revenue, urging him to take concrete measures to ensure transparency and development of non-energy sectors. Aliyev said the GOAJ recognized those dangers and had taken

steps early on to counter them. The GOAJ was one of the first to join the Extractive Industries Transparency Initiative; its State Oil Fund is internationally audited and all expenditures of energy revenue are included in the GOAJ's consolidated budget and approved by parliament. To date, the GOAJ has used its oil revenues to build schools, medical centers and housing for citizens who have been displaced by the Nagorno-Karabakh conflict. New initiatives for 2006 include a water project, and the creation of an investment fund to stimulate growth in the non-oil sectors. Aliyev added that the GOAJ also has used oil revenue to increase salaries and pensions, all the while keeping a careful eye on inflationary pressures. Aliyev's goal is to eliminate poverty by the end of 2008.

¶10. (C) Krasner urged Aliyev to take greater steps on democratic reform, noting that the USG expects the May 13 parliamentary rerun elections to go well. Aliyev agreed that further reform was needed, but cautioned that Azerbaijan's development must be viewed within a broader regional context. Azerbaijan's geography and regional threats -- including Iran, the spread of Islamic extremism, and the unresolved Nagorno-Karabakh conflict -- pose unique challenges and dictate that Azerbaijan must have realistic reform goals. However, Azerbaijan's top priority is to strengthen its independence; the development of strong institutions and an active political process is critical to Azerbaijan's independence. The U.S. plays a key role as a "guarantor" of Azerbaijan's independence, Aliyev said, and to that end, Azerbaijan seeks to maintain strong ties to the West, including through integration into the Euro-Atlantic structure.

¶11. (U) S/P Director Krasner and EUR DAS Bryza cleared this message.
HARNISH